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RR RUEHLMC
DE RUEHMC #0643/01 1801657
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FM AMEMBASSY MANAGUA
TO RUEHC/SECSTATE WASHDC 4287
INFO RUEHZA/WH CENTRAL AMERICAN COLLECTIVE
RUEHCV/AMEMBASSY CARACAS 1363
RUCPDOC/DEPT OF COMMERCE WASHINGTON DC
RUEATRS/DEPT OF TREASURY WASHINGTON DC
RHEFDIA/DIA WASHINGTON DC
RHEHNSC/NSC WASHINGTON DC
RUEHLMC/MILLENNIUM CHALLENGE CORP WASHDC

C O N F I D E N T I A L SECTION 01 OF 02 MANAGUA 000643

SIPDIS

E.O. 12958: DECL: 06/29/2029
TAGS: EFIN ECON EAID NU
SUBJECT: NICARAGUA: ORTEGA CUTS SPENDING AT IMF BEHEST, BUT DEFICIT INCREASES

REF: MANAGUA 571

Classified By: Ambassador Robert J. Callahan for reasons 1.4 b & d.

Summary

¶1. (C) On June 22, IMF Resident Representative Humberto Arbulu Neira told the Ambassador that Nicaragua has a "60 percent" chance of obtaining IMF budget support for 2009 and 2010. To improve the odds, Arbulu said that Nicaragua must cut expenditures from the 2009 budget. In line with the IMF request, on June 24 the Executive Branch submitted budget to the National Assembly that would cut overall spending from \$1.64 billion to \$1.56 billion. However, due to decreased revenues, the fiscal deficit could actually increase from \$324 million to \$369 million. Thus, without international financial institutions replacing funds withdrawn by European donors in the wake of fraudulent municipal elections held in November 2008, the government could face a major fiscal crisis. However, we expect that one way or another the Ortega administration will find a way to fill the budget gap.

IMF Requests Budget Cuts

¶2. (C) On June 22, IMF Resident Representative Humberto Arbulu Neira briefed the Ambassador on his recent visit to IMF headquarters. Arbulu accompanied officials from the Nicaraguan Central Bank and Ministry of Finance in Washington as they sought to conclude negotiations for IMF budget support (Ref A). He estimated that Nicaragua's chances of obtaining budget support for 2009 and 2010 stood at about "60 percent." To improve Nicaragua's odds, Arbulu told the Ambassador that the government must amend the 2009 budget to cut expenditures. In addition to spending cuts, Arbulu told the Ambassador that IMF officials considered tax and pension reform to be high-priority mandates for Nicaragua. On tax reform, Arbulu said that the IMF wants to see the Nicaragua decrease the number of tax exemptions currently granted to many "nonproductive" sectors of the economy.

¶3. (C) While Arbulu praised Central Bank President Antenor Rosales' presentation of the Nicaraguan case in Washington, he said the IMF is somewhat hesitant to grant budget support to the government--\$35 million in 2009, with an additional \$50 million from the World Bank and Inter-American Development Bank (IDB) contingent on an IMF program--unless a very sound case is made. The IMF does not want to be seen as replacing donor support canceled by European donors outraged over the government's failure to respond constructively to charges of massive electoral fraud in the November 2008 municipal elections. Moreover, Arbulu told the Ambassador that IMF professional staff are not fully convinced that Nicaragua's case has technical merits.

Ortega Submits Budget with Spending Cuts

¶4. (C) On June 24, while attending a summit of the Bolivarian Alternative for the Americas (ALBA) held in Venezuela, President Ortega said, "Not having an agreement with the IMF would paralyze everything." That same day, the executive branch delivered an amendment to the 2009 budget to the National Assembly. In line with the IMF request, the budget would cut overall spending from \$1.64 billion to \$1.560 billion. Reflecting a decrease in tax collections, the new budget forecasts revenue of \$1.19 billion, down from \$1.32 billion in the original budget. According to this scenario, the fiscal deficit could actually increase, from \$324 million to \$369 million. Of this amount, as much as \$238 million is to be financed with short-term domestic debt. External financing--principally from the IMF, World Bank, and IDB--would cover the balance, about \$131 million.

Comment

¶5. (C) If the IMF (together with the World Bank and IDB) do not come through with funding, Nicaragua could be plunged into a major fiscal crisis.

CALLAHAN